SSA SWISS ADVISORS

MARKET OUTLOOK

3 August 2020

Ivo Kaufmann
Chief Investment Officer

Key points:

- **Game changer for the EURO!**
- **Choppy economic recovery**
- **Need to see economic figures and earnings improving**
- **Golden cross established in major equity markets**
- **Keep equity exposure at neutral**
- **Equities not overvalued compared to bonds**
- **Gold "hype"**
- **Can Donald turn the tide again?**

SSA Swiss Advisors AG
Uraniastrasse 34
CH – 8001 Zurich
Tel: +41 (0)44 206 60 40

www.ssaswissadvisors.com
info@ssaswissadvisors.com

Market Outlook

While equity market selling lows – like the one we have seen in March – usually get tested with a "W" shaped bottom (retest), there are - like always - exceptions to the rule. The pattern we have seen since March is one of these exceptions.

From today's point of view, the retest of the lows did not happen due to the unprecedented action of Central Banks and Governments. Major Central Banks have put a floor into the market. For comparison to former crisis, the monthly asset purchases in March by G7 countries was five times that of the previous monthly record in April 2009. In the two months of March and April, the combined asset purchases of the Fed and the ECB was EUR 2.8 trillion. Statements by the Fed and ECB in June have detailed further asset purchases. For example, in Europe, the ECB has committed to a net EUR 140 billion per month of asset purchases for the rest of the year.

In the US the Congress already approved a USD 3 trillion economic relief program in May which will probably be increased by another trillion soon.

Moreover, the EU's agreement on a EUR 750 billion recovery fund together with a new seven-year EUR 1.074 trillion budget is a landmark achievement in European integration. It roughly doubles the regular EU budget's size for the next three years with some countries receiving significant transfers. Although the deal still falls short of realizing a fiscal union it will help underpin the monetary union. **For the market perceptions about the long-term viability of the EUR this is a game changer.** It tremendously reduces the risk of a EUR break up which was hanging over the euro zone since 2012.

On the economic front, the global composite Purchase Manager Index[1)] (PMI) surged again in June bringing it to a reading of 47.7 points. Although this level is far from where we would like it to be under normal circumstances, it indicates a much more modest pace of decline in global activity as of the end of Q2 than what was initially feared.

Since the beginning of the recession, we've argued that the chance of a V-shaped recovery is highly unlikely. It will take the global economy a long time to recuperate from the destruction wrought by the worldwide lockdowns and, in the face of no near-term end to the global pandemic, consumers and businesses will remain cautious.

Indeed, as economies reopened, the weekly growth in new COVID-19 cases globally has been consistently rising at a record pace. Sentiment measures that are already available for July are beginning to show signs that some of the recovery euphoria may be fading in light of these renewed COVID-19 outbreaks. However, unless governments around the world decide to simultaneously go on complete lockdown again, we believe that the worst of the downturn is behind us. We don't think that governments will be able to allow a repeat of the economic damage caused by previous lockdowns. **Nevertheless the rise in COVID-19 cases will no doubt imply a choppy recovery.**

Thus, before the encouraging abundance of liquidity can be considered a bullish driver for the economy, we **will need to see economic figures improving further (for example the Global Composite PMI) along with positive earnings growth from companies.**

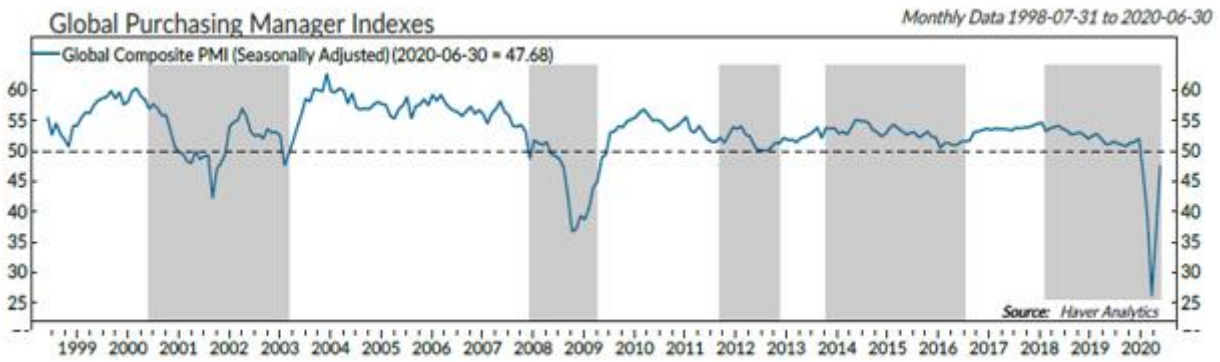


Chart Global PMI 1998 – 2020 / source: Ned Davis

Equities

Ned Davis Research has recently compared the equity market pattern after Covid-19 with the plunge following the 9/11 attacks (which was a black swan event as well). After 9/11 the equity market rallied for many months in what appeared to be a new bull market. However, it was ultimately stopped by yet another down leg of a bear market. Also, after a bounce in the economy, there was another down leg as well. While this cannot be adapted verbatim to today's circumstances, it is helpful as it shows that the current equity market strength has to be taken with caution until it will be validated by real earnings (despite **the golden crosses established in many markets during July** (where the 50 day moving average (green line) crosses the 200 day moving average (red line) on the upside (see chart below)).

To us – as already mentioned in our update on May 19th – the S&P500 level of 3'000 points is a very critical level. As long as this level can be maintained, we continue to give the market the benefit of the doubt and **keep our neutral equity exposure unchanged**.

Although we have a cautious view for the equity market and share some of the concerns that equities are expensive, we would also like to mention some factors in favor of equities. First, P/E ratios and market capitalization to GDP do not take into account zero bond yields. Investors are willing to pay higher prices to get a decent dividend yield and the potential for capital gains compared to nearly zero returns for bonds.

Therefore, we have to compare equity valuations in relation to bond yields. The equity risk premium has to be in line with bond yields. Investors have to get compensated for accepting the equity risk. Thus, the equity risk premium has to be positive. If we look at this, stocks are actually quite fairly valued. The Equity risk premium is still slightly higher than the yield for BBB bonds (according to NDR research). **If we compare this to former stock market peaks (1987 and 2000), where BBB bonds yielded 400 basis points more than equities, today's valuation compared to bonds seems reasonable.**

Chart S&P500 with moving averages / source: Factset

Forex/Gold

Gold has reached new highs in July driven by the uncertainty caused by Covid-19, ultra-low yields and a falling USD. It currently looks overbought and a consolidation phase would be a healthy development that could relieve the **speculation and hype surrounding new records**. Historically, gold had the tendency to advance during equity bear markets and decline during bull markets. Therefore it is important to watch the price development of gold, not only as we hold positions, but also due to the fact that continuing gold strength would be a signal for potential weakness in the equity market. At the moment it would be premature to conclude that we are seeing those developments. However, the gold price is something which should definitively get our attention.

Chart Gold USD/oz. 1990 - 2020/ source: Factset

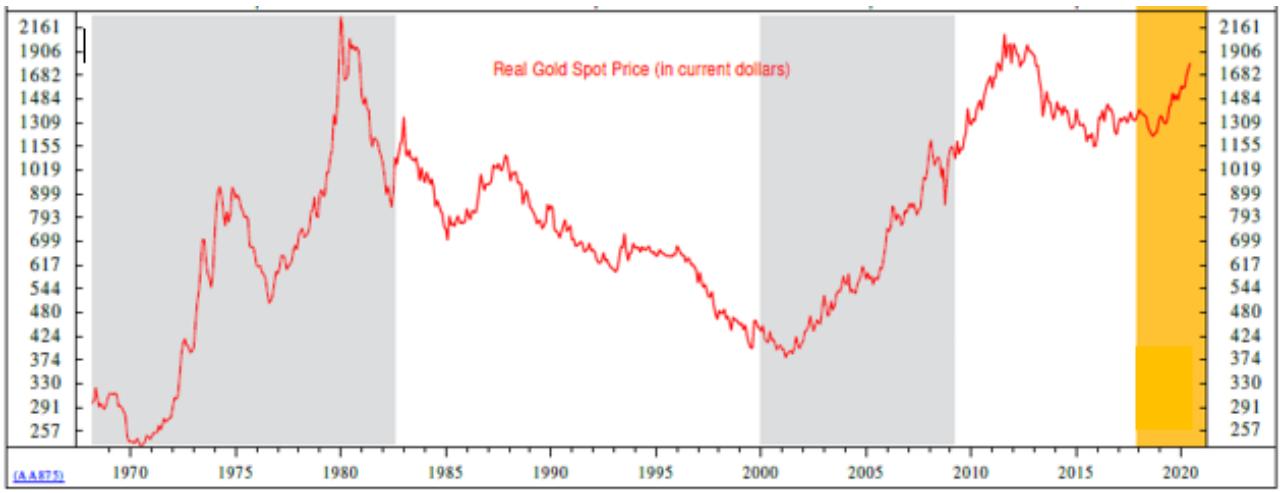


Chart Gold USD/ inflation adjusted 1970 – 2020 / source: Ned Davis

US Elections

With less than 100 days to go, the election campaign will heat up after the summer and we would like to share some thoughts we have with you.
The 2020 election will take place under unprecedented circumstances. It is coming against the backdrop of a severe recession, global pandemic, and social unrest. This is one reason why historical analogies have to be taken with caution. Under normal circumstances, President Trump's reelection chances would be close to zero. First, a recession is usually one of the worst events for an incumbent. Second, no president has been reelected with an approval rating that low (38%) at the end of June. Third, the polls currently show Joe Biden ahead of President Trump. Nevertheless, we would not rely on this at the moment. A lot can still happen and **the big question is whether the crowd sentiment moves again in favor of Trump** or whether voters will blame President Trump for the recession which was after all caused by an exogenous shock.
Without taking a position, we would like to mention that the equity market has performed better during years when the incumbent party has retained the White House, a tendency even more pronounced under Republicans. Therefore, at least according to historical data, a reelection of Donald Trump would be the favorite outcome for the US equity market. If Joe Biden wins, the market will be afraid of higher taxes depending on the situation in the congress. In any case the political uncertainty will weight on the market through November 3.

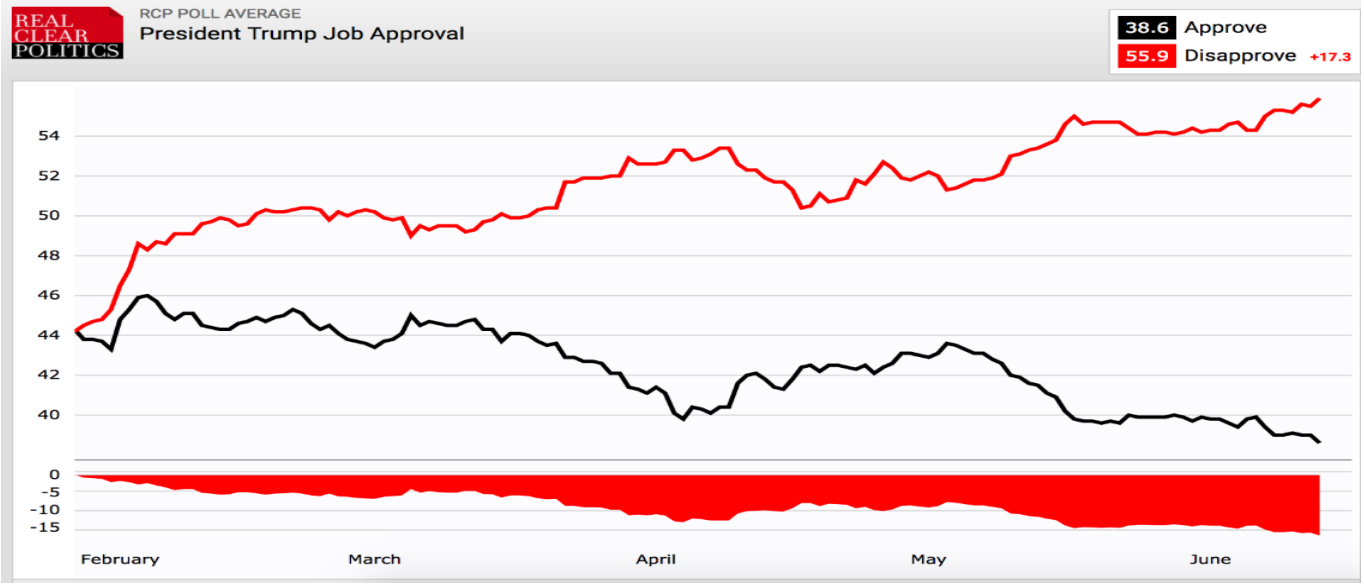


Chart Donald Trump Approval Rating / source: RealClearPolitics

Please do not hesitate to contact us if you have further questions.
Best Regards
Ivo

1) The Purchasing Managers' Index (PMI) is an index of the prevailing direction of economic trends in the manufacturing and service sectors. It is a diffusion index that summarizes whether market conditions, as viewed by purchasing managers, are expanding, staying the same, or contracting. The purpose of the PMI is to provide information about current and future business conditions to company decision makers, analysts, and investors.

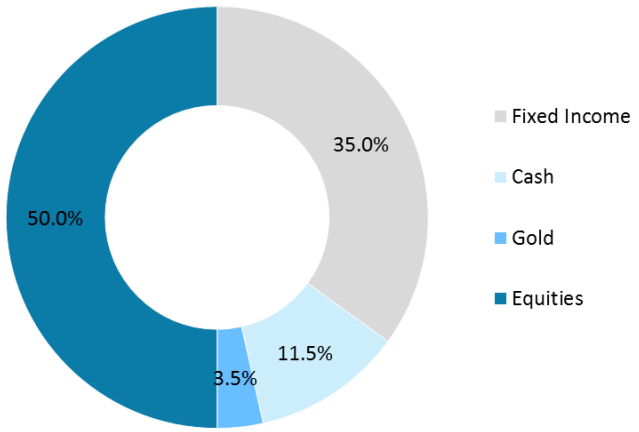
Source: Ned Davis Research, Financial Times

Asset Allocation

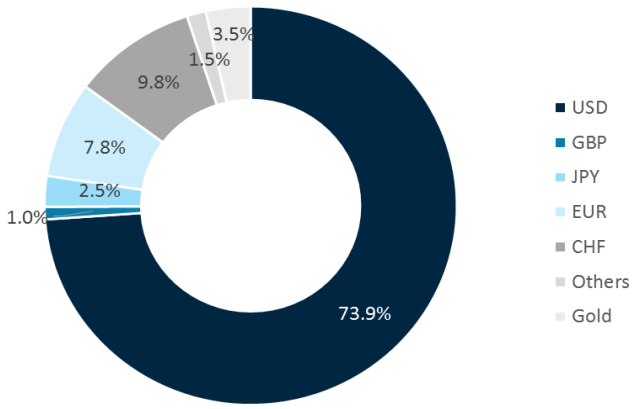
Given the factors described, we keep our equity allocation at neutral. (USD and CHF Balanced details below).

Current Allocation USD Balanced

Asset Allocation

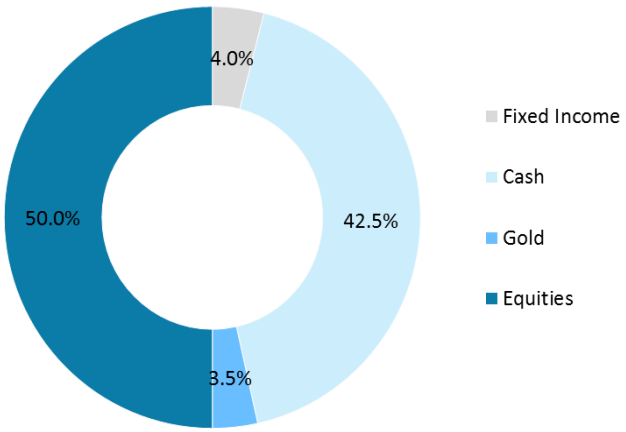


Currency Allocation



Current Allocation CHF Balanced

Asset Allocation



Currency Allocation